

Report
of the
Examination of
United Health of Wisconsin Insurance Company, Inc.
Appleton, Wisconsin
As of December 31, 1997

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July 29, 1998

Honorable Connie L. O'Connell
Commissioner of Insurance
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

UNITED HEALTH OF WISCONSIN INSURANCE COMPANY, INC.
Appleton, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of United Health of Wisconsin Insurance Company, Inc.
(the HMO) was conducted in 1995 as of December 31, 1994. The current examination covered
the intervening period ending December 31, 1997, and included a review of such 1998
transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the HMO's operations,
and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Provider Contracts
- Territory and Plan of Operations
- Affiliated Companies
- Growth of The HMO
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing
- Enrollee Complaint Procedure
- Underwriting

Emphasis was placed on the audit of those areas of the HMO's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the HMO to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the HMO's operations is contained in the examination work papers.

An independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code, annually audits the HMO. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The United Health of Wisconsin Insurance Company, Inc. (UHOW) can be described as a for-profit stock health maintenance organization insurer organized under ch. 611, Wis. Stat. The company's major line of business is a network model health maintenance organization (HMO) product. An HMO is defined by s. 609.01 (2), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that make available to its enrolled participants, in consideration for predetermined fixed payments, comprehensive health care services performed by providers selected by the organization." Under the network model, the HMO provides physicians care services through contracts with more than one group practice. HMOs compete with traditional fee-for-service health care delivery.

The HMO was incorporated February 2, 1988, and commenced business April 1, 1988. Prior to September 29, 1995, UHOW was a wholly owned subsidiary of United Investors, Inc. On September 29, 1995, Aurora Ventures, Inc., purchased a 25% ownership interest in UHOW. At present, the HMO is 75% owned by United Investors, Inc. (UII), and 25% owned by Aurora Health Care Ventures, Inc. UII, a for-profit stock corporation, is a holding company. UII is 49.9% owned by United Health Group, Inc. (UHG), a not-for-profit organization and 50.1% owned by other investors.

UHOW contracts with groups and individual physicians for the provision of primary and specialist care services. Currently, the HMO contracts with 270 primary care physicians and 540 specialists. The HMO requires enrollees to choose a primary care physician (PCP) who serves as a gatekeeper. The PCP must preauthorize all referrals to specialists.

Under the participating provider agreement, the physician agrees to provide medically necessary covered health services to enrollees who have selected the provider for primary care services or who are referred by other participating providers for specialty care. PCPs are compensated at the maximum allowable level or the billed amount, whichever is less. The maximum allowable level is based upon the unit values established by Relative Value Studies, Inc. Primary Care Physicians compensation is subject to maximum funding which is

defined as a percentage of premium revenue, as determined by the plan. PCP services are subject to a 10% withhold, the disposition of which is determined by the HMO. Specialty Services Physicians are compensated on a fee-for-service basis subject to maximum funding which is defined as a percentage of premium revenue, as determined by the HMO. Specialty services are subject to a 20% withhold, the disposition of which is determined by the plan. Risk withhold due to health care providers was \$2,394,008 at December 31, 1997. The agreement provides that in no event shall the provider bill enrollees for covered services.

The HMO currently contracts with approximately 76 IPAs and clinics. The major IPAs and clinics are listed below:

| | |
|--|---|
| Appleton Family Health Center | Fox Valley Internal Medicine |
| Arturch Clinic | Geen Lake Medical Clinic |
| Associated Family Physicians of Berlin & Wautoma, S.C. | Green Lake Family Practice |
| Aurora Medical Group, Inc. | Internal Medicine Associates of Oshkosh |
| Berlin Medical Group | Internal Medicine Associates of Neenah |
| Children's Health | Kaukauna Clinic, S.C. |
| Children's Clinic of Oshkosh, S.C. | Mc Donald Clinic |
| CHN Internal Medicine Clinic | Oconto Primary Care |
| Clintonville Family Practice | Seymour Family Medicine Clinic |
| Family Health Services, S.C. | Shawano Clinic, Inc. |
| Family Practice Associates of Oshkosh | Waupaca Family Medicine |
| Family Practice of Neenah | Waushara Family Physicians |
| Family Doctors, S.C. | |

The contracts include hold-harmless provisions for the protection of policyholders. The contracts have a one-year term and may be terminated by either party upon 90 days' written notice in advance of the expiration date.

The HMO contracts with 18 hospitals to provide inpatient services. Hospitals are reimbursed based on diagnostic related groups. The HMO retains a percent of monthly premium revenue for hospitalization services in a hospital fund. Hospitals are paid for services from the fund. Fund deficits derived from United Health Group (UHG) providers are reimbursed 100% by UHG. Remaining fund deficits are absorbed 100% by the plan. Noncontracting hospitals are paid based on a usual and customary basis. The contracts include hold-harmless provisions for the protection of policyholders.

The following is a listing of hospitals in which participating physicians have admitting privileges. Contracting hospitals are denoted with an asterisk (*).

Appleton Medical Center, Appleton, WI*
Berlin Hospital, Green Bay, WI
Berlin Memorial Hospital, Berlin, WI*
Calumet Medical Center, Chilton, WI*
Community Memorial, Oconto Falls, WI
Mercy Medical Center of Oshkosh, Inc., Oshkosh, WI*
Holy Family, Manitowoc, WI
Oconto Memorial Hospital, Oconto, WI*
New London Family Medical Center, New London, WI*
Ripon Medical Center, Ripon, WI*
Riverside Medical Center, Waupaca, WI*
Shawano Medical Center, Shawano, WI*
St Mary's Kewaunee Area Memorial Hospital, Kewaunee, WI*
Theda Clark Regional Medical Center, Neenah, WI*
Two Rivers Community, Two Rivers, WI*
St. Agnes Hospital, Fond du Lac, WI*
Wild Rose Community Memorial Hospital, Wild Rose, WI*
University of Wisconsin Hospital & Clinics, Madison, WI*¹

¹ Referral required to use this facility

UHOW is authorized to do business in Brown, Calumet, Dodge, Fond du Lac, Green Lake, Jefferson, Kenosha, Marinette, Menomonie, Milwaukee, Oconto, Outagamie, Ozaukee, Portage, Racine, Rock, Shawano, Sheboygan, Walworth, Washington, Waukesha, Waupaca, Waushara, and Winnebago counties. The HMO offers a high option comprehensive health care coverage, which may be changed by riders to include deductibles and copayments.

The following basic health care coverages are provided:

- Physician services
- Inpatient services
- Outpatient services
- X-ray and laboratory tests
- Pregnancy services
- Newborn services
- Ambulance services
- Routine eye examinations
- Hearing exams and hearing aids
- Family planning
- Physical fitness or health education (\$50.00 reimbursement per adult member, maximum two per family per calendar year)
- Chiropractic services
- Physical, speech, and/or occupational therapy
- Cardiac rehabilitation
- Prosthetic devices, disposable medical supplies, and durable medical equipment
- Certain transplants
- Dental services for repairs and replacement due to bodily injury
- Mental health, drug, and alcohol abuse services
- Skilled nursing care facility
- Home health care
- Diabetes treatment
- Kidney disease treatment
- Prescription drugs (\$5 to \$10 copayment)

Inpatient mental health and AODA coverage is limited to \$6,300.00 per contract year, outpatient mental health and AODA coverage is limited to \$1,800.00 per contract year.

Emergency room charges are 100% covered after a \$25.00 or \$50.00 copayment. The copayment is waived for certain plans upon admission into an inpatient facility. Skilled nursing care is limited to 30 days per post hospital confinement and home health care is limited to 40 visits per calendar year. Enrollees are required to choose a primary care provider from a list of participating physicians. Plan coverage is contingent on nonemergency services being provided by participating physicians and hospitals or on the referral of participating physicians.

The HMO also has copayment plans in which inpatient services have a \$100 per day copayment subject to maximums of \$500/single and \$1,000 /family contract; and office visits have a \$10 copayment per visit. In addition, deductible plans are offered in which inpatient and outpatient services and durable medical equipment have deductibles ranging from \$100 to \$500 for individual and \$200 to \$1,000 for family per contract year, and 100% coverage thereafter. Office visits under the deductible plan are subject to a \$10 copayment per visit.

The HMO offers point-of-service (POS) products that provide two levels of coverage, an in-plan and an out-of-plan level. Coverage for in-plan service is similar to comprehensive HMO benefits described in the previous paragraph. The enrollee has the option to self-refer to out-of-plan (nonparticipating) providers. Out-of-plan services have deductibles of \$200 to \$1,000 per individual and \$400 to \$2,000 per family; and coinsurance requirements of 20% or 30% (10% for mental health and substance abuse services). There is a lifetime maximum of \$1 million or \$5 million on out-of-plan services. Coverage for routine physical examinations, well-baby care, immunizations, and routine eye and hearing exams is not provided as an out-of-plan benefit.

UHOW currently markets to groups only. The HMO uses internal marketing staff and independent agents for new and renewal business. The marketing staff receive salaries and applicable bonuses as compensation. Independent agents receive commissions on a graduated scale. For new business, agent commissions start at 12% for the first \$5,000 of annual premium and graduate to 0.25% for annual premium above \$200,000. For renewal business, agents' commissions start at 6% for the first \$5,000 of annual premium and graduate to 0.25% for annual premium above \$200,000. The company has a marketing and administrative agreement with Employers Health Insurance Company (EHIC). Under the contract, EHIC becomes a marketing and administrative agent for UHOW's products sold to employer groups of 2 to 99 employees. For those services, EHIC is paid 5.5% of premium, 2% for profit and 3.5% to cover their administrative overhead.

The HMO uses an actuarially determined base as a beginning point in premium determination. This rate is adjusted to reflect the age, sex, occupation, and coverage

characteristics for new groups. Experience is reviewed for renewal groups and, based on the review, a recommendation is made regarding adjusting the rate or canceling the group. The base rate is adjusted quarterly for inflation and other trending factors.

The HMO has developed procedures to monitor the actions of its primary care physicians. Physicians' licenses and admitting privileges are verified by the credentialing committee of the board. In addition, the company has a utilization review/quality management committee that meets monthly to a) analyze and monitor monthly utilization statistics, b) evaluate benefit coverage issues, c) monitor quality indicators, d) track and review member grievances, e) address physician risk management issues, and f) facilitate continuous quality improvement activities that improve the health status of the population. As another control feature, the UHOW medical director must preauthorize all elective out-of-plan referral procedures. Failure to preauthorize can result in sanctions to the provider.

The company has procedures to be followed in the event of subscriber grievances.

1. All grievances must be in writing and filed with a United Health Member Advocate.
2. United Health will acknowledge the grievance within ten business days of receipt. A notice is mailed of the date of the next Grievance Committee meeting. The meeting will be scheduled to provide at least seven calendar days' notice.
3. In the event that the grievance is resolved in the member's favor prior to the scheduled Grievance Committee meeting date, a Member Advocate will notify the member.
4. The Grievance Committee will include a Plan Medical Director, physicians, and internal representatives and at least one United Health Member who is not an employee of United Health. The Grievance Committee will notify the member of its resolution within 30 calendar days of the initial receipt of the grievance.
5. If United Health is unable to resolve the grievance within 30 calendar days, the time period may be extended an additional 30 calendar days. United Health will notify the member in writing that it has not resolved the grievance, when resolution may be expected, and the reason why additional time is needed.
6. If, after the initial Grievance Committee meeting, the grievance is not resolved to the satisfaction of the member, he/she may request for hearing by a second level committee- the Utilization Management Committee (UM). The UM Committee is made up of primary care physicians and specialty physicians excluding those serving on the Grievance Committee. Request for a second level hearing must be submitted in writing to the Member Advocate. A United Health Member Advocate will notify the member of the determination made by the UM Committee within 5 business days of the meeting.

Urgent care grievances are handled on an expedited basis and must be resolved within four business days following receipt.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of 16 members. Four directors are elected annually to serve a 3-year term. Officers are appointed by the board of directors. According to the company's bylaws, the chairman, vice-chairman, secretary, and treasurer are elected by the board of directors at its annual meeting to serve 2-year terms. All other officers of the corporation shall be appointed annually. Members of the HMO's board of directors may also be members of other boards of directors in the holding HMO group. The board members currently receive no compensation for serving on the board

Currently the board of directors consists of the following persons:

| Name and Residence | Principal Occupation | Term Expires |
|--|--|---------------------|
| Curtis Baltz, M.D. Neenah, WI | Internal Medicine | 1999 |
| Oscar Boldt Appleton, WI | Chairman and CEO, The Boldt Group | 1998 |
| Clark Boren, M.D. Appleton, WI | Physician, Fox Valley Surgical Associates | 1999 |
| Sue Buettner Milwaukee, WI | Director-Network Services, Aurora Health Care | 1998 |
| Michael Duffy, M.D. Oshkosh, WI | Physician, Oshkosh Internal Medicine | 1998 |
| Dean M. Gruner, M.D. Appleton, WI | Chief Medical Officer, UHOW | 1998 |
| William Guenther, M.D. Appleton, WI | Physician, Fox Valley Oncology and Hematology | 1998 |
| Jonathan Hagen, M.D. Appleton, WI | Physician, Family Doctors North | 1998 |
| Tom Koehler, M.D. Green Bay, WI | Physician, Decker Clinic | 1998 |
| John Lindstrom, M.D. Appleton, WI | Physician, Lindstrom Orthopedic Clinic | 2000 |
| Terrence Murray Neenah, WI | Vice President-Consumer Business Services, Kimberly Clark Corporation | 2000 |

| | | |
|-----------------------------------|--|------|
| Donald Nestor Milwaukee, WI | Senior Vice President, Aurora Health Care | 1999 |
| Warren Parsons Appleton, WI | President, Oscar J. Boldt Construction | 2000 |
| Thomas Prosser Neenah, WI | Senior Vice President, Robert W. Baird & Co., Inc. | 1999 |
| Frank Wiesner Neenah, WI | Robert W. Baird & Company, Inc. | 1999 |
| Robert Wubben, M.D. Neenah, WI | Physician, Orthopedic Clinic of Neenah | 1998 |

Officers of the Company

The officers elected or appointed by the board of directors and serving at the time of this examination are as follows:

| Name | Office | 1997 Salary |
|------------------------|-------------------------|--------------------|
| Clark Boren, MD | Chairman | \$ 0 |
| Thomas Prosser | Vice Chairman | 0 |
| Curtis Baltz, MD | Secretary | 0 |
| Terrence Murray | Treasurer | 0 |
| Jay Fulkerson | President | 275,471 |
| Dean M. Grunner, MD | Chief Medical Officer | 216,302 |
| Jeffery S. Hacker, CPA | Chief Financial Officer | 126,860 |

Committees of the Board

The HMO's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Finance Committee

Jeff Hacker, Chair
Curtis Baltz, M.D.
Jay Fulkerson
Dean Gruner, M.D.
Pat Hawley
Kathy Ledvina
John Lindstrom, M.D.
Bob Malte
Terrance Murray
Warren Parsons
Frank Wiesner

Management Committee

Jay Fulkerson
Carmen Backman
Loretta Baehr
John Barkmeier, M.D.
John Chacos
Craig Clifford
Lori Desorcy
Greg Devine
Susan Dietrich
Jim Enright
Dean Gruner, M.D.
Jeff Hacker
Julie Imig
Lynn Kerkhoff
Debbie Ludka
Bob Malte
Terry Maves
David Meulemans
Cindy Mischler
Sandy Panzer
Nancy Pontius
Jodi Ratajczak
Lisa Sell

Quality Committee

John Barkmeier, Chair
Clark Boren, M.D.
Michael Duffy, M.D.
William Guenther, M.D.
Carol Machek
Bob Malte
Robert Meade, M.D.
Marty Myse
Sandy Panzer
Chris Watson, M.D.
Frank Wiesner
Martin Wikoff, Ph.D.

Utilization Management Committee

John Barkmeier, M.D., Chair
James Basiliere, M.D.
Bruce Danz, M.D.
Robert Devermann, M.D.
David Duppler, M.D.
Montgomery Elmer, M.D.
Julie Giese
Bev Hill
Sue Hill
Bonnie Johnson
David Johnson, M.D.
John Kemp
John Lindstrom, M.D.
Bob Malte
Hassan Shahbandar, M.D.
Lee Vogel, M.D.

The HMO has no employees. Necessary staff is provided through a support services agreement with United Health Group (UHG). Under the agreement, effective March 1, 1995, UHG agrees to negotiate employer, provider, subscriber, and other contracts; advises the board; maintains accounting and financial records; recruits marketing, utilization review, and claims processing personnel; provides or contracts for claims processing, and MIS. UHG receives a monthly fee based on an allocation of the prior 12 months' costs as compensation for services rendered. This fee is \$170,643 per month for 1998. The term of the agreement is 3 years with automatic renewal for additional 3-year periods. The HMO may terminate the agreement upon 30 days' written notice if default of standards of performance continues 60 days after notice of such default.

Financial Requirements

The financial requirements for an HMO under s. Ins 3.50, Wis. Adm. Code, are as follows:

| | Amount Required |
|---|--|
| 1. Minimum capital or permanent surplus | Either: \$750,000, if organized on or after July 1, 1989 or \$200,000, if organized prior to July 1, 1989 |
| 2. Compulsory surplus | The greater of \$750,000 or: If the percentage of covered liabilities to total liabilities is less than 90%, 6% of the premium earned in the previous 12 months; If the percentage of covered liabilities to total liabilities is at least 90%, 3% of the premium earned in the previous 12 months |
| 3. Security surplus | The greater of: 140% of compulsory surplus reduced by 1% of compulsory surplus for each \$33 million of additional premiums earned in excess of \$10 million or 110% of compulsory surplus |
| 4. Operating funds | Funds sufficient to finance any operating deficits in the business and to prevent impairment of the insurer's initial capital or permanent surplus or its compulsory surplus |

Covered liabilities are those due to providers who are subject to statutory hold-harmless provisions.

In addition, there is a special deposit requirement equal to the lesser of the following:

1. An amount necessary to maintain a deposit equaling 1% of premium written in this state in the preceding calendar year;
2. One-third of 1% of premium written in this state in the preceding calendar year.

The HMO has satisfied this requirement for 1997 with a deposit of \$919,568 with the State Treasurer.

Insolvency Protection for Policyholders

Under s. Ins 3.50, Wis. Adm. Code, HMOs are required to provide continuation of coverage for its enrollees. These requirements are the following:

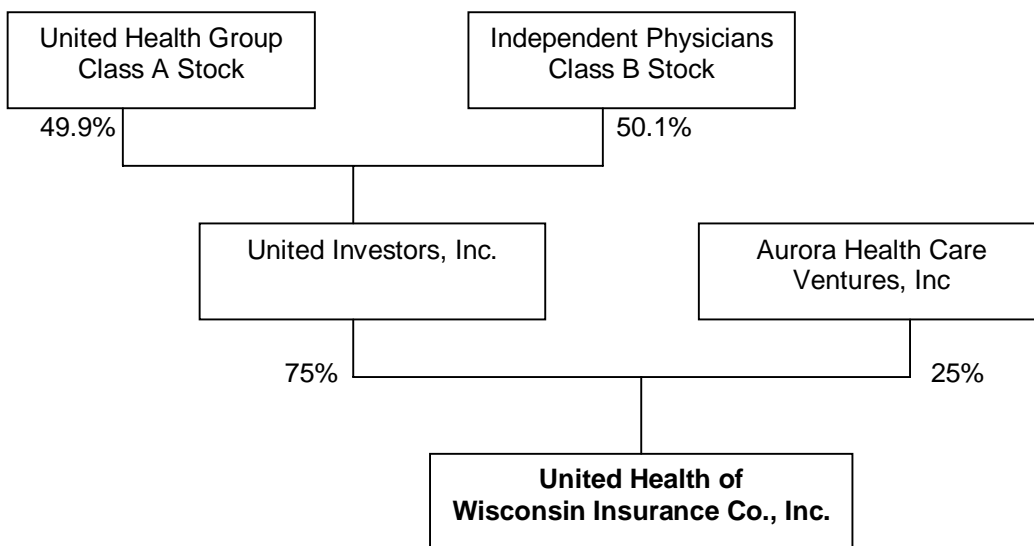
1. Enrollees hospitalized on the date of insolvency will be covered until discharged; and
2. Enrollees will be entitled to similar, alternate coverage which does not contain any medical underwriting or preexisting limitation requirements.

The HMO has met this requirement through its reinsurance contract, as discussed in the Reinsurance section of this report.

IV. AFFILIATED COMPANIES

The HMO is a member of a holding company system. Its ultimate parent is United Health Group, Inc. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of the HMO follows the organizational chart.

**Holding Company Chart
As of December 31, 1997**



United Health Group, Inc.

United Health Group, Inc., is a nonprofit organization incorporated in 1985 and exempt from income taxes under section 501 (c) (3). UHG is a health care provider system owning two hospitals, a number of primary care (family practice, pediatrics, and internists) clinics, a nursing home, and other ancillary health care providers. As of December 31, 1997, the UHG's audited financial statement reported assets of \$249 million, liabilities of \$103 million, and net assets of \$147 million. Operations for 1997 produced net income of \$13 million.

The HMO has a Support Services Agreement with UHG to provide management, operation, and information system support. The HMO leases approximately one-half of the office space in its home office to UHG. The lease agreement, effective September 1994, has a term of

nine years. The annual rental was \$166,224 in 1997. In addition were overhead cost for receptionist, mailroom, and occupancy cost totaling \$173,772 for 1997.

United Investors, Inc.

United Investors, Inc. (UII), a for-profit stock corporation, is a holding company. UII is 49.9% owned by United Health Group, Inc. (UHG), a not-for-profit organization and 50.1% owned by other investors. As of December 31, 1997, the UII's consolidated audited financial statement reported assets of \$42.4 million, liabilities of \$30.2 million, and shareholders' equity of \$12.2 million. Operations for 1997 produced net income of \$287,000.

V. REINSURANCE AND CORPORATE INSURANCE

The HMO has reinsurance coverage under the contract outlined below:

1. Reinsurer: Standard Security Life Insurance Company of New York
- Type: Stop Loss Reinsurance
- Effective date: October 1, 1997
- Retention: \$100,000 of eligible hospital services per member in each contract year.
- Coverage: Eligible hospital services, out of area emergency hospital services.
- Limitations -
- (a) Organ Transplant:
90% of eligible hospital services fee after annual deductible for in-plan hospital providers. For other hospital providers, reimbursement is at 50% of hospital charges.
 - (b) Services Other Than Organ Transplant:
90% of hospital charges in a network hospital and 80% in non-network hospital.
 - (c) Maximum Reimbursement :
\$1,000,000 of coverage, per member per contract year before deductible and coinsurance.
- Premium: \$0.84 per member per month (pmpm) for Medicaid members.
\$0.54 pmpm for all members except Medicaid members.
- Termination: September 30, 1998

The reinsurance policy has an endorsement containing the following insolvency provisions:

1. Standard Security Life Insurance Company of New York will continue plan benefits for members who are confined in an acute-care hospital on the date of insolvency until their discharge.
2. Standard Security Life Insurance Company of New York will continue plan benefits for any member insured plan until the end of the contract period for which premiums have been paid to plan by that member or on his behalf.
3. Standard Security Life Insurance Company of New York will make available to all members for a period of 31 days, without evidence of insurability, a replacement coverage of the same benefit schedule and rates as then being offered by Standard Security Life Insurance Company of New York to other prospective insureds within the state.

2. Reinsurer: Employers Health Insurance Company (EHIC)
- Type: POS Indemnity Reinsurance
- Effective date: January 1, 1995
- Retention: None
- Coverage: Stop loss for in-network and authorized out-of-plan claims in excess of 90% of POS premium in any contract year.
- 100% of self-referred out-of-plan claims.
- Premium: 1% of premium for in-network and authorized out-of-plan coverage.
20% of allocated premium for self-referred out-of-plan coverage.
- Termination: December 31, 1998.

In addition, the HMO, together with other affiliated companies of UHG, is named as an insured and provided with corporate insurance coverage under the contracts listed below:

| Type of Coverage | Policy Limits |
|--|--|
| Directors' and officers' liability | \$ 20,000,000 each loss, 20,000,000 aggregate |
| Property | 404,000,000 blanket, subject to specified sublimits |
| Crime | |
| Employee dishonest | 1,000,000 each occurrence, 5,000 deductible |
| Theft | 1,000,000 |
| Forgery | 250,000 |
| Computer fraud | 1,000,000 |
| Comprehensive general liability | 1,000,000 aggregate |
| Managed care professional liability and managed care errors and omissions liability | 10,000,000 |
| Automobile liability | 1,000,000 |
| Umbrella liability | 40,000,000 |
| Fiduciary liability | 1,000,000 |

The above coverages were obtained through insurers licensed in Wisconsin.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the HMO as reported in the December 31, 1997, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Net Worth per Examination." Also included in this section are schedules that reflect the growth of the HMO for the period under examination.

United Health of Wisconsin Insurance Company, Inc.
Balance Sheet
As of December 31, 1997

Current Assets:

| | | |
|--|----------------|--------------|
| Cash and short-term Investments | \$11,972,944 | |
| Premiums receivable--net | 2,612,935 | |
| Interest income receivable | 123,905 | |
| Health care receivables | 832,313 | |
| Reinsurance recoverable on paid losses | 1,045,561 | |
| Aggregate write-ins for other current assets | <u>935,718</u> | |
| Total current assets | | \$17,523,376 |

Other Assets:

| | | |
|----------------------------------|------------------|------------|
| Restricted cash and other assets | 919,568 | |
| Bonds | 6,668,525 | |
| Preferred stocks | <u>4,094,814</u> | |
| Total other assets | | 11,682,907 |

Property and Equipment—Net:

| | | |
|----------------------------------|---------------|------------------|
| Land, building, and improvements | 5,025,373 | |
| Furniture and equipment | 1,032,762 | |
| Leasehold improvements | <u>16,828</u> | |
| Total property and equipment | | <u>6,074,963</u> |

Total Assets \$35,281,246

Current Liabilities:

| | | |
|---|------------------|--------------|
| Accounts payable | 819,989 | |
| Claims payable (reported and unreported) | 20,700,318 | |
| Unearned premiums | 2,697,163 | |
| Amounts due to affiliates | 381,685 | |
| Aggregate write-ins for other current liabilities | <u>1,588,790</u> | |
| Total current liabilities | | \$26,187,945 |

Other Liabilities:

| | | |
|---------------------------------|----------------|------------|
| Accrued loss adjustment expense | <u>344,000</u> | |
| Total Liabilities | | 26,531,945 |

Net Worth:

| | | |
|--------------------------------|------------------|------------------|
| Common stock | 679,400 | |
| Paid-in surplus | 4,412,633 | |
| Retained earnings/fund balance | <u>3,657,268</u> | |
| Total net worth | | <u>8,749,301</u> |

Total Liabilities and Net Worth \$35,281,246

United Health of Wisconsin Insurance Company, Inc.
Statement of Revenue and Expenses
For the Year 1997

Revenues

| | | |
|--------------------|------------------|---------------|
| Premium | \$114,655,362 | |
| Title XIX-Medicaid | 9,901,475 | |
| Investment | 1,125,105 | |
| Other revenue | <u>1,157,765</u> | |
| Total revenue | | \$126,839,707 |

Medical and Hospital Expenses

| | |
|---|-------------------|
| Physician services | 52,832,824 |
| Other professional services | 22,429,558 |
| Inpatient | 29,181,027 |
| Incentive pool and withhold adjustments | (6,788,813) |
| Hospital outpatient expenses | <u>24,875,891</u> |
| Subtotal | 122,530,487 |

Less:

| | | |
|---------------------------------|------------------|-------------|
| Net reinsurance claims incurred | 1,098,346 | |
| Copayments | 3,005,854 | |
| COB and subrogation | <u>4,706,256</u> | |
| Subtotal | <u>8,810,456</u> | |
| Total medical and hospital | | 113,720,031 |

Administrative Expenses

| | | |
|---|------------------|-------------------|
| Compensation | 5,139,717 | |
| Interest expense | 597 | |
| Occupancy, depreciation, and amortization | 488,494 | |
| Marketing | 639,784 | |
| Aggregate Write-ins for | <u>6,471,263</u> | |
| Total administrative expenses | | <u>12,739,855</u> |

| | |
|----------------|--------------------|
| Total expenses | <u>126,459,886</u> |
|----------------|--------------------|

| | |
|--------|---------|
| Income | 379,821 |
|--------|---------|

| | |
|------------------------------------|---------------|
| Provision for federal income taxes | <u>18,518</u> |
|------------------------------------|---------------|

| | |
|------------|--------------------------|
| Net Income | <u><u>\$ 361,303</u></u> |
|------------|--------------------------|

United Health of Wisconsin Insurance Company, Inc.
Statement of Net Worth
As of December 31, 1997

| | |
|--|---------------------|
| Net worth, beginning of year | \$ 9,892,665 |
| Increase in paid-in surplus | 585,937 |
| Increase (decrease) in retained earnings/fund balance: | |
| Net income | 361,303 |
| Increase in nonadmitted assets | (2,606,002) |
| Unrealized gain - equities | <u>515,398</u> |
| Net worth, end of year | <u>\$ 8,749,301</u> |

United Health of Wisconsin Insurance Company, Inc.
Statement of Cash Flows (Indirect Method)
As of December 31, 1997

Cash Flows From Operating Activities

| | |
|---|------------------|
| Net income | \$ 361,303 |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | |
| Depreciation and amortization | 354,484 |
| Change in operating assets and liabilities: | |
| (Increase)/Decrease in operating assets: | |
| Premium receivable | (2,013,212) |
| Due from affiliates | (2,606,002) |
| Health care receivable | 649,652 |
| Write-ins for (increase)/decrease in operating assets | (1,259,191) |
| Increase/(decrease) in operating liabilities: | |
| Medical claims payable | 11,597,639 |
| Due to affiliates | (55,751) |
| Unearned premiums | 2,048,095 |
| Accounts payable | 418,498 |
| Write-ins for (increase)/decrease in operating liabilities | <u>(483,085)</u> |
| Net cash provided from operating activities | 9,012,430 |

Cash Flows From Investing Activities

| | |
|---|----------------|
| Payments for restricted cash and other assets | 919,568 |
| Payments for investments | (1,120,882) |
| Payments for property, plant, and equipment | (2,327,605) |
| Write-ins for investing activities | <u>515,398</u> |
| Net cash used by investing activities | (2,103,521) |

Cash Flows From Financing Activities

| | |
|---|---------------------|
| Proceeds from paid-in capital or stock issuance | <u>585,937</u> |
| Net increase in cash and cash equivalents | 7,494,846 |
| Cash and cash equivalents at beginning of year | <u>4,478,098</u> |
| Cash and Cash Equivalents at End of Year | <u>\$11,972,944</u> |

Growth of United Health of Wisconsin Insurance Company, Inc.

| Year | Assets | Liabilities | Net Worth | Premium Earned | Medical Expenses Incurred | Net Income |
|------|--------------|--------------|-------------|----------------|---------------------------|-------------|
| 1994 | \$21,509,990 | \$15,404,196 | \$6,105,794 | \$ 57,907,696 | \$ 47,586,589 | \$1,763,997 |
| 1995 | 22,280,466 | 12,430,726 | 9,849,740 | 69,019,736 | 61,475,471 | 1,244,872 |
| 1996 | 22,899,214 | 13,006,549 | 9,892,665 | 80,824,061 | 70,302,322 | 2,757,274 |
| 1997 | 35,281,246 | 26,531,945 | 8,749,301 | 124,556,837 | 113,720,031 | 361,303 |

Enrollment and Utilization

| Year | Enrollment | Hospital Days/1,000 | Average Length of Stay |
|------|------------|---------------------|------------------------|
| 1994 | 52,544 | 175.98 | 2.68 |
| 1995 | 61,709 | 196.38 | 2.83 |
| 1996 | 63,772 | 247.60 | 3.23 |
| 1997 | 97,576 | 256.06 | 3.08 |

Per Member Per Month Information

| | 1997 | 1996 | Percentage Change |
|---------------------------|-----------------|-----------------|-------------------|
| Premiums: | | | |
| Commercial | \$114.16 | \$110.60 | 3.2% |
| Medicaid | <u>110.17</u> | <u>N/A</u> | N/A |
| Expenses: | | | |
| Physicians services | 48.28 | 55.37 | -12.8% |
| Other professional | 20.50 | 10.21 | 100.7 |
| Inpatient | 26.67 | 22.24 | 19.9 |
| Incentive pool adjustment | -6.20 | -5.56 | 11.7 |
| Other medical | 22.73 | 21.35 | 6.5 |
| Net reinsurance claims | -1.00 | -0.68 | 47.8 |
| Copayments | 2.75 | 1.97 | 39.3 |
| COB and subrogation | <u>4.30</u> | <u>4.71</u> | -8.7 |
| Total Medical | 103.93 | 96.26 | 8.0 |
| Administrative Expense | <u>11.64</u> | <u>11.40</u> | 2.1 |
| Total Expenses | <u>\$115.57</u> | <u>\$107.66</u> | 7.3% |

In 1997, the HMO implemented several changes in their provider contracts and reinsurance agreements, which significantly increased medical expenses.

- In 1996, UHOW entered a capitation agreement with UHG such that UHOW's hospital risk was capitated and UHG took full responsibility of related benefit payments. In 1997, this

agreement was changed so that UHG was only responsible for services provided by hospitals within their own group.

- In 1996, UHOW capitulated the primary care physician risk (PCP). In 1997, UHOW reimburses PCPs on a fee schedule basis and continues to maintain a withholding fund to encourage cost-saving measures.
- In 1996 and prior period, UHOW and Employers Health Insurance Company (EHIC) offered POS coverage for members. Under this arrangement, UHOW retained the in-plan risk and EHIC retained the out-of-plan risk. EHIC also provides UHOW with a 90% loss ratio stop-loss reinsurance contract for in-plan risks. This contract changed in 1997 so that all in-plan and out-of-plan POS risks are retained by UHOW.
- In 1996, UHOW ceded 100% of the risk for small employer groups (groups with less than 100 employees) to EHIC in a "cost-plus" agreement. UHOW began retaining 100% of this risk when groups renew in 1997.
- UHOW began offering Medicaid business in December of 1996. The Medicaid business has grown considerably in 1997.

In addition to the above factors, comparability between 1996 and 1997 was impaired by changes made in 1997 to expense accounts grouping for annual statement reporting. The 1996 figures have not been reclassified to conform with 1997 presentation.

.Reconciliation of Net Worth per Examination

This examination made no adjustment to the net worth as reported by the HMO. No examination reclassification was made as a result of this examination.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 8 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the HMO are as follows:

1. **Corporate Records** - It is recommended that the company file biographical information for company officers and directors with OCI within 15 days after their appointment or election as required by s. 611.57, Wis. Stat., and s. Ins 6.54, Wis. Adm. Code.

Action: Noncompliance - see "Summary of Examination Results - Financial"

2. **Corporate Insurance** - It is recommended that the company maintain fidelity insurance coverage in an amount that is in accordance with the NAIC's recommended level.

Action: Compliance

3. **Long-term Investments** - It is recommended that the company transfer custody of its securities to a bank or banking and trust company as required by s. 610.23, Wis. Stat.

Action: Compliance

4. **Long-term Investments** - It is recommended that the company obtain safekeeping agreements, which include the provisions contained in the NAIC Examiners Handbook.

Action: Noncompliance - see "Summary of Examination Results – Financial."

5. **Long-term Investments** - It is recommended that the company execute an agreement with United Investors Company, Inc., which clearly segregates investments and describes each party's rights, responsibilities, and compensation under the investment arrangement.

Action: Not applicable. The HMO no longer commingles investments with United Investors, Inc. Accordingly, such an agreement is not necessary.

6. **Financial Statements** - It is recommended that the company complete the annual statement in accordance with the NAIC HMO Annual Statement Instructions.

Action: Partial compliance - see "Summary of Examination Results - Financial"

7. **Other Accrued Liabilities** - It is recommended that the company notify Health Insurance Risk Sharing Plan (HIRSP) of the error in reporting 1994 to be used for 1995 assessments.

Action: Compliance

8. **Other Accrued Liabilities** - It is recommended that the company remit the \$26,382 amount due to the HIRSP fund.

Action: Compliance

Summary of Current Examination Results

Cash

The review of the bank reconciliations revealed that the HMO had set up a liability account for long outstanding checks. However, the required filing with the state of Wisconsin for abandoned property has not been made. It is recommended that the company file unclaimed property reports as required by ch. 177, Wis. Stat.

Investments

The current safekeeping agreement with a broker specifically limit liability of the custodian for the acts, omissions or defaults of any agent properly delegated and appointed with due care by the broker. The agreement did not contain adequate provisions for (a) proper segregation of amounts, (b) indemnification of the HMO for securities lost due to the negligence or dishonesty of the custodian and/or its employees, and (c) prompt replacement of the securities lost and the value of any lost rights. It is again recommended that the company amend its safekeeping agreement to include provisions required by the NAIC Examiners Handbook.

Management and Control

The examiner's review of the minutes of the meetings of the board of directors and finance committee for the period under examination noted that neither the board nor the finance committee pass upon the purchase and sale of investments. Also, the HMO disclosed in its response to the General Interrogatories #11 of the 1997 annual statement that neither the board nor the finance committee passes upon the purchase and sale of investments. Pursuant to s. 611.51, Wis. Stat., it is recommended that either the board of directors or a subordinate committee pass upon the purchase or sale of all investments of the HMO, and that the minutes of the proceeding reflect the same.

Financial Reporting

The OCI Instructions to the Report on Executive Compensation, a supplemental filing with the HMO's 1997 annual statement requires disclosure of the CEO, four most highly paid officers or employees and all employees with earnings in excess of \$80,000. The examination noted that the HMO has not disclosed compensation for individuals falling into the disclosure

category. It is recommended that the HMO file amended 1997 Report on Executive Compensation (Form OCI 22-060) for proper disclosure of officers and employees compensation. Also, it is recommended that the HMO report on executive compensation in the future as required by s. 611.63 (4), Wis. Stat.

Certain officers and a director listed below were not disclosed as officers or director of the HMO on the filed annual statement for 1996 and 1997.

| Name | Office |
|-------------------|--|
| Clark Boren, M.D. | Chairman |
| Thomas Prosser | Vice Chairman |
| Terrence Murray | Treasurer |
| George Kerwin | Member of the Board of Directors (1996) |

It is recommended that the HMO disclose all of its officers and directors in the annual statement in accordance with the NAIC HMO Annual Statement Instructions.

The examiners noted the following exception in the filed annual statement for 1997:

- The company reported prescription drug expenses on 1997 Annual Statement page 4, line 10, Other Professional Services. Such an item should be reported on the 1997 Annual Statement page 4, line 16, Aggregate Write-Ins for Other Medical and Hospital Expenses.

The above error was mentioned in the prior examination report as of December 31, 1994. It is recommended again, that the company complete the annual statement in accordance with the NAIC HMO Annual Statement Instructions.

Corporate Records

The company is required to submit biographical information on newly appointed directors and officers to OCI within 15 days after their appointment or election. The examination noted that biographical data for the 2 new directors elected in the period covered were not filed with OCI within 15 days. It is again recommended that the HMO file biographical information for its officers and directors with OCI within 15 days after their election or appointment as required by s. 611.57, Wis. Stat., and s. Ins 6.54, Wis. Adm. Code.

The HMO has adopted procedures for the annual disclosure of potential or actual conflict of interest on the part of any of its officers and directors. The procedure requires that a disclosure statement be circulated annually to provide a method for reporting situations, which are, or may be construed as, a conflict of interest. The examination noted upon review that conflict of interest statements have not been completed on an annual basis by all the directors. Also, the examination noted that there is no disclosure requirements in place for the HMO's senior management staff. It is recommended that the conflict of interest statement be completed annually by all directors, officers, and senior management employees.

According to the HMO's bylaws its chairman, vice chairman, secretary and treasurer are elected to a 2-year term while all other officers are elected annually to a 1-year term. A review of the minutes of the board of directors meetings disclosed that the current chairman, vice chairman, secretary, and treasurer were duly elected by the board on January 9, 1997, to a 2-year term. However, the examiner was unable to ascertain the appointment of other officers (President, Chief Medical Officer and Chief Financial Officer) by the board of directors. Also, it was not evident from the minutes that the two new directors in 1998 (Jonathan Hagen, M.D., and Warren Parsons) were elected by the board members as required in the bylaws. It is recommended that the minutes of the board of directors meetings reflect election of directors and appointment of officers in conformity with the HMO's bylaws.

EDP Environment

Company personnel were interviewed by the examiners with respect to the company's electronic data processing environment. The company's control environment appears to adequately secure its data with the following exception:

1. User IDs are not locked out when three attempts at a password fail.

It is recommended that the company change its computer access security to lock out User IDs after a password has been incorrectly entered three times.

Compulsory Surplus Requirement

As noted in the section of this report captioned "Financial Requirements," HMOs are required to maintain minimum compulsory surplus. The HMO's calculation as of December 31, 1997, as modified for examination adjustments, is as follows:

| | | |
|---|-------------------|--------------------|
| Assets | \$ 35,281,246 | |
| Less: | | |
| Special deposit | 919,568 | |
| Liabilities | <u>26,531,945</u> | |
| Total | | \$7,829,733 |
| Net premium earned-Incidental indemnity premium | 5,418,735 | |
| Compulsory factor | <u>10%</u> | |
| | <u>541,874</u> | |
| Net premium earned-HMO business | 119,138,102 | |
| Compulsory factor | <u>3%</u> | |
| | <u>3,574,143</u> | |
| Compulsory surplus | | <u>4,116,017</u> |
| Compulsory Excess | | <u>\$3,713,716</u> |

VIII. CONCLUSION

United Health of Wisconsin Insurance Company, Inc. incorporated on February 2, 1988, is a for profit stock health maintenance organization insurer licensed and operating in Wisconsin under ch 611, Wis. Stat. The HMO is a 75% owned subsidiary of United Investors, Inc., a subsidiary of United Health Group.

The HMO experienced significant growth in revenue and membership in the period covered by this examination. During the period 1995-1997, membership increased by 86% to 97,576 enrollees, while premium revenue increased by 115%. The HMO operations were profitable in 1997 and each of the prior two years. The net worth at December 31, 1997 was \$3,713,716 in excess of the minimum surplus requirement.

The examination made 10 recommendations and no adjustment to surplus. Two of the recommendations were repeated from the prior examination report at 1994.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 26 - Cash—It is recommended that the company file unclaimed property reports as required by ch. 177, Wis. Stat..
2. Page 26 - Investments—It is again recommended that the company amend its safekeeping agreement to include provisions required by the NAIC Examiners Handbook.
3. Page 26 - Management and Control—It is recommended that either the board of directors or a subordinate committee pass upon the purchase or sale of all investments of the HMO, and that the minutes of the proceeding reflect the same.
4. Page 27 - Financial Reporting—It is recommended that the HMO file amended 1997 Report on Executive Compensation (Form OCI 22-060) for proper disclosure of officers and employees compensation. Also, it is recommended that the HMO report on executive compensation in the future as required by s. 611.63 (4), Wis. Stat.
5. Page 27 - Financial Reporting—It is recommended that the HMO disclose all of its officers and directors in the annual statement in accordance with the NAIC HMO Annual Statement Instructions.
6. Page 27 - Financial Reporting—It is recommended again, that the company complete the annual statement in accordance with the NAIC HMO Annual Statement Instructions.
7. Page 28 - Corporate Records—It is again recommended that the HMO file biographical information for its officers and directors with OCI within 15 days after their election or appointment as required by s. 611.57, Wis. Stat., and s. Ins 6.54, Wis. Adm. Code.
8. Page 28 - Corporate Records—It is recommended that the conflict of interest statement be completed annually by all directors, officers, and senior management employees.
9. Page 28 - Corporate Records—It is recommended that the minutes of the board of directors meetings reflect election of directors and appointment of officers in conformity with the HMO's bylaws
10. Page 32 - Corporate Records—It is recommended that the company change its computer access security to lock out User IDs after a password has been incorrectly entered three times.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the HMO is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

| Name | Title |
|-----------------|--------------------|
| Teri McClintock | Insurance Examiner |
| Randy Milquet | Examiner Advanced |

Respectfully submitted,

Akin Morakinyo
Examiner-in-Charge
Bureau of Financial Analysis and Examinations

United Health.doc